AMERICANS FOR TaxFairness

NEXT STEPS TOWARD TAX FAIRNESS:

Options for Closing Loopholes for the Richest 2% and Big Corporations

The fiscal-cliff tax deal passed by Congress in early January was only a first step toward ensuring that the richest Americans pay their fair share of taxes. And it did not ask corporations to contribute any new tax revenues to help reduce the deficit or to make new investments to grow the economy.

By closing loopholes and ending tax breaks for powerful special interests, Congress can raise the revenue needed to reduce the deficit, protect vital programs, and make the economy strong again. A summary of options for doing that is below; a more detailed list follows.

SUMMARY: OPTIONS FOR RAISING TAX REVENUES OVER 10 YEARS	
1. End corporate tax breaks for shifting jobs and profits offshore	$221-$606 billion
2. Close other corporate tax loopholes and tax breaks	$162 billion
3. Place a small sales tax on Wall Street trading	$353 billion
4. Limit tax deductions for the richest 2%	$513 billion
5. Close loopholes that allow the very wealthy to shield income from taxation	$1.5-$1.7 trillion
6. Place a 5%-5.6% surtax on the incomes of millionaires or multimillionaires	$107-$453 billion

Note that not all of the more than 275 organizations that make up Americans for Tax Fairness necessarily endorse all of these options. However, they agree that the first priority of Congress should be to create a more fair tax system, rather than reducing the deficit on the backs of the middle class and the poor – and that there are multiple ways of advancing that goal.

The fiscal-cliff tax deal passed by Congress in early January was only a first step toward ensuring that the richest Americans pay their fair share of taxes. And it did not ask corporations to contribute a dime to help reduce the deficit or to make new investments to grow the economy.

The middle class and the poor are still bearing most of the burden when it comes to reducing the deficit: in federal budget agreements so far, there has been $1.5 trillion in program cuts and just $600 billion in new tax revenues.[1] That means for every $2.50 in cuts there has been just $1 in new revenue. Because of the fiscal-cliff tax deal, some rich Americans will have to pay a little more in taxes – but many loopholes and tax breaks that benefit corporations and the wealthy went untouched.

A recent poll by Hart Research shows that Americans agree: Congress should require the richest 2 percent to pay more in taxes and close corporate tax loopholes, rather than cut Social Security, Medicare and Medicaid benefits, education and other vital programs.[2]

DETAILED OPTIONS FOR RAISING TAX REVENUES OVER 10 YEARS	Savings ($ billions over 10 years)

End corporate tax breaks for shifting jobs and profits offshore
• End the ability of U.S. corporations to delay paying taxes on foreign profits by repealing "deferral. Deferral allows corporations to delay paying taxes on the profits from their overseas subsidiaries until those profits are repatriated back to the U.S. This would tax profits made overseas the same as profits made in the U.S., with a credit for foreign taxes paid [Savings: $606 billion; Joint Committee on Taxation (JCT) estimate updated by Citizens for Tax Justice (CTJ)]
• Close various international tax loopholes
  ▪ End companies taking immediate deductions against their U.S. taxes for interest expenses associated with offshore operations [$65 billion; JCT/CTJ]
  ▪ Make sure the foreign tax credit, which prevents double taxation, does not exceed the amount necessary to achieve that goal [$60 billion; JCT/CTJ]
  ▪ Reduce abuses that shift patents and other intangible property to tax havens [$21 billion; JCT/CTJ]
  ▪ Eliminate or reform "check-the-box" rules that make it easy for corporations to move profits to overseas tax havens [$41 billion; JCT/CTJ]
	$221-$606

Close other corporate tax loopholes and tax breaks • End abuses of inventory accounting (Repeal "Last In, First Out" (LIFO) and "Lower of Cost or Market" (LCM) rules) [$70 billion; JCT] • End special fossil-fuel tax breaks [$25 billion; JCT] • End stock option loopholes [$25 billion; JCT] • Cap tax deductibility of executive compensation, which was done under TARP and the ACA [$42 billion; Economic Policy Institute]	$162
Place a small sales tax on Wall Street trading Apply a tax of 30 cents for every $1,000 in trades (0.03 percent) of stocks, bonds, derivatives, and other financial products [$353 billion; JCT]	$353
Limit tax deductions for the richest 2% Reduce the value of tax deductions and exclusions to 28%, as proposed by President Obama, which would affect the richest 2% [$513 billion; JCT estimate updated by CTJ).	$513
Close loopholes that allow the very wealthy to shield income from taxation • Close the inherited capital gains tax loophole [Savings: About $500 billion; JCT] • Tax capital gains and dividends of the richest 2% at the same rate as ordinary income [About $500 billion; CTJ] • Restore a robust estate tax affecting fewer than 2% of estates [$114-249 billion; JCT) • Close loopholes in the estate tax [$24 billion; Treasury Dept.] • Curb the deferral of tax on income from the purchase of annuities or life insurance policies by wealthy investors [$260 billion; Congressional Budget Office (CBO)] • Limit excessive IRA accumulations for investment fund managers [No estimate] • Ensure millionaires pay at least a 30% tax rate ("Buffett Rule") [$54 billion; JCT] • Close the "like-kind exchange" loophole, which allows real-estate investors and multinational corporations to sell property at an appreciated price while avoiding capital gains taxes [$28 billion; CTJ] • Close the "carried interest" loophole for investment fund managers [$17-21 billion; JCT and CBO] • Eliminate the Medicare loophole for S Corporations [$11 billion; JCT] • Deny the mortgage interest deduction for vacation homes and yachts [$15 billion; Committee for a Responsible Federal Budget] • Close the tax loophole for derivatives traders [$3 billion; JCT]	$1,526-$1,665
Place a 5%-5.6% surtax on the incomes of millionaires or multimillionaires • Set a $1 million threshold at 5.6% [$453 billion; JCT] • Set a $10 million threshold at 5% [$107 billion; JCT]	$107-$453

NEXT STEPS TOWARD TAX FAIRNESS:

Options for Closing Loopholes for the Richest 2% and Big Corporations

Income at the top has soared in recent years as the income of the middle class has stagnated. The average federal tax rate for the top 1 percent of households declined from 35.1 percent to 28.9 percent between 1979 and 2009.[3] The share of federal revenue from the corporate income tax has plummeted by 75 percent in the last 60 years,[4] while corporate America's profits have soared. Meanwhile, over the last 4 years, federal revenues have been the lowest they've been as a share of the economy since 1950: Revenues have averaged 15.4 percent, compared to 20 percent during 1998-2001, the last time the federal budget was balanced.[5]

The middle class and the poor are still bearing most of the burden when it comes to reducing the deficit. It's time for Congress to require the richest 2 percent and corporations to pay their fair share of taxes, rather than cut Social Security, Medicare and Medicaid benefits, education and other vital programs. Multiple options for doing just that are described below.

I. End Tax Breaks to Corporations for Shifting Jobs and Profits Offshore

Revenue: $221-606 billion over 10 years; Joint Committee on Taxation estimate updated by Citizens for Tax Justice

The largest corporate tax loopholes are those that allow multinational corporations to avoid U.S. tax by locating investments or profits offshore. The fundamental way in which our tax system encourages the offshoring of jobs and corporate profits is that U.S. multinationals are allowed to "defer" (delay) paying taxes on the profits of their overseas subsidiaries until those profits are "repatriated" (brought back to the U.S.). As the Congressional Budget Office (CBO) explains:

> *The current tax system provides incentives for U.S. firms to locate their production facilities in countries with low taxes as a way to reduce their tax liability at home. Those responses to the tax system reduce economic efficiency because the firms are not allocating resources to their most productive use…The current system also creates incentives to shift reported income to low-tax countries without changing actual investment decisions.*[6]

In other words, our tax code subsidizes companies that shift profits and actual operations overseas, which costs revenue and jobs and ultimately drives down the wages of U.S. workers. The use of dodgy accounting schemes to shift corporate profits to offshore tax havens costs the United States as much as $90 billion a year in revenue.[7] Reforms are needed to stanch this massive revenue loss and level the playing field for investment and job creation in the United States.

There are two basic approaches to addressing tax breaks for corporate offshoring. The stronger approach would repeal deferral entirely. The more modest approach would close various loopholes that subsidize offshoring and allow tax avoidance.

- **End the Ability of U.S. Corporations to Delay Paying Taxes on Foreign Profits by Repealing "Deferral"**
  Revenue: $606 billion over 10 years; Joint Committee on Taxation estimate updated by Citizens for Tax Justice

  The way to completely remove the tax incentives to send jobs and profits offshore is simply to repeal deferral. Then U.S. corporations would pay current U.S. taxes on their foreign profits, as they do on domestic profits. They would continue to receive a credit for foreign taxes paid on their offshore profits (the foreign tax credit) so that they would never pay combined U.S. and foreign taxes at a rate exceeding the U.S. corporate tax rate.

  Senator Bernie Sanders (I-VT) has introduced legislation (S. 250) to repeal deferral. This proposal was also contained in bipartisan legislation sponsored by Sen. Ron Wyden (D-OR) and Sen. Dan Coats (R-IN) in 2010. The JCT estimated then that repealing deferral would raise $583 billion over 10 years if it took effect in 2011; Citizens for Tax Justice estimates it would raise $606 billion over 10 years if it takes effect in 2014.[8]

- **Close Various International Tax Loopholes**
  Revenue: $221 billion over 10 years; Joint Committee on Taxation estimates updated by Citizens for Tax Justice

  Another approach would be to adopt a set of multinational corporate tax reforms like those President Obama has proposed in his budgets that would reduce incentives for corporations to shift jobs and profits overseas, prevent corporations from claiming credit for foreign taxes they didn't pay, and crack down on tax havens. Overall, these 13 measures would raise about $221 billion over 10 years, based on JCT estimates updated by Citizens for Tax Justice, while reducing subsidies for corporate offshoring.[9] The largest of these reforms would:

  - End the practice of companies taking immediate deductions against their U.S. taxes for expenses associated with their offshore operations while deferring indefinitely the U.S. taxes on the resulting offshore profits: **$65 billion over 10 years.**
  - Help ensure that the foreign tax credit, which is supposed to prevent double-taxation of foreign profits, does not exceed the amount necessary to achieve that goal: **$60 billion over 10 years.**

- Reduce abuses involving intangible property like patents and trademarks, which are particularly easy to shift to tax haven-based subsidiaries that are really no more than a post office box: **$21 billion over 10 years.**
- Reform the rules relating to "dual capacity taxpayers," which allow multinational corporations such as large oil companies to claim foreign tax credits for payments that are essentially royalties, and therefore should not be creditable as foreign income taxes: **$10 billion over 10 years.**
- Eliminate or reform "check-the-box" rules that make it easy for corporations to move profits to overseas tax havens and avoid tax by "checking a box" that transforms subsidiaries into entities that don't have to pay tax: **At least $41 billion over 10 years.**[10]

In his "Framework for Business Tax Reform," President Obama also proposed a minimum tax on corporations' foreign profits to deter tax haven abuse, level the playing field for domestic investment, and prevent a global "race to the bottom" on corporate tax rates.[11] The details of the minimum tax proposal have yet to be released.

Public opinion on these tax reform options

- By a margin of 83% to 13%, voters want to "Increase taxes on the profits that American corporations make overseas, to ensure they pay as much on foreign profits as they do on profits made in the United States."
- By a margin of 73% to 25%, voters want to "Close loopholes that allow corporations and wealthy individuals to avoid paying U.S. taxes by shifting income to overseas tax havens."
  Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

II. Close Other Corporate Tax Loopholes and Tax Breaks

- **End Abuses of Inventory Accounting (Repeal "Last in, First Out" (LIFO) and "Lower of Cost or Market" (LCM) Rules**
  Revenue: $70 billion over 10 years; Joint Committee on Taxation

  The tax code currently allows companies to choose the most favorable method of valuing their inventory and cost of goods sold. Many taxpayers choose the "Last In, First Out," or LIFO, method, which can provide a substantial tax-deferral benefit. As Citizens for Tax Justice explains, "LIFO allows companies to deduct the (higher) cost of recently acquired or produced inventory, rather than the (lower) cost of older inventory."[12] LIFO, however, has been described as an inefficient and unnecessary subsidy for certain businesses, including oil companies, and it is not allowed by International Financial Reporting Standards.

A related and similarly flawed accounting method known as "Lower of Cost or Market" (LCM) allows businesses to choose whether to value inventory at its cost or market value, whichever is less, resulting in apparently smaller profits—and lower tax. Phasing out LIFO and LCM over a transition period would raise $69.9 billion over 10 years according to the Joint Committee on Taxation.[13]

- **End Special Fossil-Fuel Tax Breaks**
  Revenue: $25 billion over 10 years; Joint Committee on Taxation

The oil and gas industry continues to collect billions in special tax subsidies every year – relics of old energy policies that are simply not needed at a time when oil prices approach $100 per barrel.[14] The G-20 nations have agreed to phase out inefficient and wasteful fossil-fuel subsidies. President Obama has proposed to eliminate the following tax breaks, which would raise $24.9 billion over 10 years, according to the JCT:[15]

- Expensing of intangible drilling costs
- Percentage depletion for oil and gas wells
- Increase two-year geological and geophysical amortization period for independent producers to seven years
- Deduction for tertiary injectants
- Exemption to passive loss limitation for working interest in oil and natural gas properties
- Expensing, percentage depletion, and capital gains tax breaks for coal

Public opinion on this tax reform option
By a margin of 59% to 36%, voters want to "Eliminate tax breaks for oil companies." Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

- **End Stock Option Loopholes**
  Revenue: $25 billion over 10 years; Joint Committee on Taxation

Under present law, corporations can claim tax deductions for executive stock options that exceed the expense that they report to their shareholders for issuing the same options. Financial reporting rules require corporations to report an expense for stock options at the time they are granted to executives, based on an estimated value of the option. Yet tax rules allow them to deduct the value of the options when they are exercised – which is typically much higher than the value they ascribe for "book" purposes. In other words, corporations are allowed to tell shareholders one thing about how options affect their profits, and tell the IRS something else.[16] Stock options are also excluded from the existing rule that limits corporate deductions for executive pay to $1 million per year.

Legislation introduced by Sen. Carl Levin (D-MI), S. 268, would prevent companies from claiming tax deductions for stock options that exceed the expense reported to shareholders, while also subjecting stock options for top executives to the $1 million limit. It is estimated to raise $25 billion over 10 years.[17]

Public opinion on this tax reform option

By a margin of 63% to 34%, voters want to "Prevent corporations from avoiding taxes when they award their executives millions of dollars in stock options."
Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

- **Cap the Tax Deductibility of Executive Compensation**
  Revenue: $42 billion over 10 years; Economic Policy Institute

Currently, there is no meaningful limit on how much corporations can deduct from their income taxes for the expense of executive compensation. The more they pay their CEO, the less they pay in taxes. As a result, ordinary taxpayers wind up subsidizing excessive executive pay.

A Clinton-era reform capped the tax deductibility of executive compensation at $1 million, but with a huge loophole: the cap doesn't apply to "performance-based" pay. This led to the increased use of stock option-based compensation that greatly expanded CEO paychecks.

Executive compensation experts found that pay arrangements that rely heavily on "performance pay" are leading managers to focus excessively on the short term, motivating them to boost short-term results at the expense of long-term value.[18] One study found that executive influence over their own pay has led to compensation schemes that weaken managers' incentives to increase firm value and even create incentives to take actions that *reduce* long-term firm value.

The Troubled Asset Relief Program (TARP) legislation and the Affordable Care Act both have provisions that closed the loophole and lowered the cap to $500,000 for executives of bailout recipients and health insurance companies. The Income Equity Act of 2013 (H.R. 199) would close the loophole for performance-based pay and extend the TARP/ACA cap on deductibility of executive compensation to all firms. This approach is estimated to generate nearly $4.2 billion in revenues annually, or roughly $42 billion over 10 years.[19]

III. Place a Small Sales Tax on Wall Street Trading

Revenue: $353 billion over 9 years; Joint Committee on Taxation

It's time for Wall Street to help Main Street by placing a very small Financial Transaction Tax (FTT) on Wall Street trading in stocks, bonds, derivatives and other financial products. A tax of just 30 cents on each $1,000 worth of trades (0.03 percent) would raise $353 billion over nine years, according to the JCT.[20]

Besides raising much-needed revenue, the FTT would reduce dangerous financial market speculation and encourage longer-term productive investment. It would hit high-volume, high-speed trading the hardest, serving to discourage short-term speculation, as well as the proliferation of ever more complex financial instruments that increasingly destabilize financial markets. By reducing the volume and profitability of short-term trading that serves no productive purpose, the tax would encourage Wall Street to find new ways to make money from longer-term, productive investments. That would mean more jobs on Main Street and an economy based on producing things rather than on speculating. Eleven European Union (EU) governments have now agreed to implement an FTT.

Public opinion on this tax reform option

By a margin of 61% to 32%, voters want to "Establish a small tax on all trading in stocks and bonds and other financial market trades. For example, for every ten thousand dollars in a trade the tax would be three dollars."
Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

IV. Limit Tax Deductions for the Richest 2 Percent

Revenue: $513 billion over 10 years; Joint Committee on Taxation updated by Citizens for Tax Justice

Under the current tax code, the highest-income taxpayers get a much larger tax break from tax deductions or exclusions from taxable income than middle-class taxpayers. For example, for a wealthy taxpayer in the 39.6 percent tax bracket who pays $10,000 in mortgage interest, the mortgage interest deduction is worth $3,960. For a middle-income taxpayer in the 15 percent tax bracket who pays the same $10,000 in mortgage interest, the deduction is only worth $1,500. This is both unfair and inefficient. It's unfair because the richest 2 percent of Americans shouldn't get a bigger tax break than middle-class families for doing things like buying a house or saving for retirement. It's inefficient because these costly tax incentives are poorly targeted at those least likely to need them or respond to them.

President Obama proposes to reform the "upside-down" problem with tax deductions and exclusions by limiting the value of several deductions and exclusions for the richest 2 percent – those households making more than $250,000 a year in taxable income – to 28 percent. In other words, the richest taxpayers would get the same tax benefit from these tax breaks as a household in the 28 percent bracket, but not more as they do now. This policy would raise an estimated $513 billion in revenue over the next decade.[21]

Public opinion on this tax reform option

By a margin of 56% to 41%, voters support "Limit[ing] tax deductions for people making over $250,000 a year."
Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

V. Close Loopholes that Allow the Very Wealthy to Shield Much of Their Income from Taxation

Revenue: $1.5-$1.7 trillion over 10 years

Very wealthy taxpayers can accumulate even more wealth – while paying little or no taxes – by taking advantage of a variety of tax breaks and loopholes that allow them to exclude, defer, or under-report income, so that much of their added wealth escapes tax altogether.[22] There are a number of approaches to close these loopholes:

- **Close the Inherited Capital Gains Tax Loophole**
  Revenue: About $500 billion over 10 years; Joint Committee on Taxation

  One of the largest loopholes in the tax code allows wealthy people to avoid capital gains tax by holding onto their assets until they die and bequeathing them to heirs. Normally, capital gains – the appreciation in value of stocks, businesses, or other assets – are taxed when a person sells them. But if a person holds onto assets until his death and passes them onto heirs, then neither the decedent nor his heirs ever have to pay capital gains taxes on the appreciation during the decedent's lifetime. As a result of this loophole, about 56 percent of the value of estates worth more than $10 million is unrealized capital gains that is never taxed.[23] This tax code rule also creates inefficiency as investors are "locked into" holding onto assets they would otherwise want to sell.

  Reforming the inherited capital gains loophole – technically called "step-up of basis at death" – could increase revenues substantially. The JCT estimates that $258 billion will be lost between 2013 and 2017 because of the exclusion of capital gains at death. Over 10 years the loss could be at least $516 billion.[24] To prevent these losses a person's estate should be required to pay capital gains tax on appreciation during that person's lifetime (perhaps with an exemption that would limit the reform to large capital gains so that the vast majority of people would be unaffected[25]).

  The deficit-reduction proposal made by Erskine Bowles and Alan Simpson, under the auspices of the National Commission on Fiscal Responsibility and Reform, also called for closing this loophole.[26]

  Another approach, which is likely to be less effective in raising revenue, would be to provide that heirs inherit assets with a "carryover basis," so that that untaxed appreciation is subject to capital gains tax when they sell assets.

  Public opinion on this tax reform option
  By a margin of 60% to 35%, voters want to "Eliminate the loophole that allows wealthy families to avoid paying any capital gains taxes on stocks and bonds that they inherit." Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

- **Tax Capital Gains and Dividends of the Richest 2% at the Same Rate as Ordinary Income**
  Revenue: About $500 billion over 10 years; Citizens for Tax Justice

  The reason very wealthy Americans like Warren Buffett and Mitt Romney pay a lower tax rate than millions of middle-class Americans is that most of their income is from selling assets like stocks and bonds, and from dividends, all of which are taxed at a special low 23.8 percent rate for people in the highest tax bracket, as opposed to the new top rate of 39.6 percent on income from work. This income from investments is also exempt from Social Security payroll taxes that working people pay on their wages. Workers who get most of their earnings from salaries or wages often pay a higher tax rate than the rich, especially when payroll taxes are included.

  These special low tax rates promote inequality and divert resources to unproductive tax shelters that would never exist but for the tax benefits. Capital gains income from stocks and bonds overwhelmingly goes to the wealthiest taxpayers. The richest 1 percent of taxpayers receive 71 percent of all capital gains, while the bottom 80 percent only get 6 percent of all capital gains, according to the Tax Policy Center.[27] Income from dividends is also heavily skewed to the wealthy, with the richest 5 percent of taxpayers receiving 68 percent of stock dividends compared with 17 percent for the bottom four-fifths of taxpayers.[28] Even among the elderly, capital gains and dividend income is highly concentrated at the top.

  Taxing capital gains and dividends at the same rates as other income is the fairest solution. Ronald Reagan signed such a measure into law in 1986.[29] However, the rates for capital gains and other types of income diverged again in the 1990s and in 2003, when tax cuts enacted under President George W. Bush lowered the top capital gains rate from 20 percent to 15 percent and lowered the tax rate for corporate stock dividends to 15 percent, from the ordinary income tax rate.

  Under the fiscal-cliff deal passed in January 2013, known as the American Taxpayer Relief Act, the top capital gains tax rate and dividends rate will rise to 20 percent for couples with income above $450,000 ($400,000 for individuals). An additional 3.8 percent tax on net investment income, enacted as part of the Affordable Care Act in 2010, will apply to couples with income above $250,000 ($200,000 for individuals). More than half of the revenue raised by this additional 3.8 percent tax – $123 billion from 2013 to 2019 – will come from the top 0.1 percent of taxpayers and 86 percent will come from the top 1 percent.[30]

  Congress should go even further and tax capital gains and dividends at the ordinary income tax rates for the richest 2 percent. Although revenue estimates for this proposal are not available, a rough comparison with the revenue raised over a shorter period by the smaller 3.8 percent tax and earlier estimates of the revenue raised from taxing capital gains as ordinary income (assuming dividends were already being taxed the same as ordinary income) shows that it should raise at least $500 billion over 10 years.[31]

Public opinion on this tax reform option

- By a margin of 52% to 36%, voters support a proposal that would "For those making over two hundred fifty thousand dollars, end the lower tax rate on income from selling stocks and other assets."
- By a margin of 48% to 39%, voters support a proposal that would "For those making over two hundred fifty thousand dollars, end the lower tax rate on dividend income from stocks."
  Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

- **Restore a Robust Estate Tax**
  Revenue: $114-$249 billion over 10 years; Joint Committee on Taxation

The estate tax is a potentially important source of federal revenue that encourages billions of dollars in charitable donations each year and is a means to make the tax system modestly progressive so that the wealthy pay a fairer share of taxes. However, the Bush tax cuts dramatically reduced the estate tax, and it was cut further by the estate tax cut enacted in 2010, which expired in 2012.

The fiscal cliff deal extended most of that temporary estate tax cut, exempting the first $10.5 million of a couple's estate from tax and applying a top tax rate of 40 percent to taxable assets above that level. At this much reduced level, only the richest 0.14 percent of estates – or 1 in 700 – will owe any estate tax in 2013,[32] and the estate tax will raise only $19 billion more over 10 years than would have been raised by extending the 2012 estate tax.[33]

Under President Obama's proposal to restore the generous estate tax parameters in effect for 2009 ($7 million exemption for couples, 45 percent top rate), only 0.26 percent of estates – or 1 in 380 – would owe any estate tax in 2013.[34] Even with so few estates subject to the estate tax, the Obama proposal would raise $114 billion more over 10 years than the deal struck in January 2013.[35]

Another proposal (H.R. 3467), introduced by Rep. Jim McDermott in 2011, set the estate tax exemption at $2.6 million per couple, which would affect fewer than 2 percent of estates.[36] It would set a top rate of 55 percent on the value of estates above that amount. This would largely restore the estate tax to where it was before the Bush tax cuts, adjusted for inflation and with some reforms. It would raise $249 billion more than the deal struck in January.[37]

- **Close Loopholes in the Estate Tax**
  Revenue: $24 billion over 10 years; Treasury Department

  Though the estate tax now allows couples to transfer $10.5 million of wealth tax-free to heirs, wealthy people use numerous aggressive strategies to avoid estate and gift taxes while transferring even larger amounts of wealth. President Obama's budgets in recent years have identified several reforms to prevent people from undervaluing their assets for estate tax purposes or using trusts as estate tax avoidance devices.[38] The Treasury Department estimated in 2012 that these reforms would raise $24 billion over 10 years.[39] That amount might be less under the now-looser estate tax parameters enacted under the American Tax Reform Act in 2013, but it is not a complete estimate of the revenue that can be raised through estate tax reform: there are undoubtedly other tax avoidance strategies that deserve further scrutiny.

- **Curb the Deferral of Tax on Income from the Purchase of Annuities or Life Insurance Policies by Wealthy Investors**
  Revenue: Up to $260 billion over 10 years; Congressional Budget Office

  Normally, when people hold investments outside of tax-preferred retirement accounts, they must pay income taxes when interest or dividends are paid from those investments or when assets are sold resulting in capital gains. However, people who buy annuities or whole-life insurance policies can effectively defer tax on their earnings from their premiums as they accumulate. The tax could be paid by individuals or directly by the company providing the annuity or insurance policy. It is estimated that curbing this loophole could save up to $260 billion, according to CBO.[40] The benefit seems to go mainly to the well-off. Data from the Federal Reserve indicates that over half of this untaxed investment income is owned by the richest 10 percent of Americans, and very little is owned by the bottom half of Americans.[41] The deficit-reduction proposal made by Erskine Bowles and Alan Simpson, under the auspices of the National Commission on Fiscal Responsibility and Reform, also taxed inside buildup on life insurance benefits at death.[42]

- **Limit Excessive IRA Accumulations for Investment Fund Managers**
  Revenue: no publicly available revenue estimate

  Tax-favored retirement accounts such as Individual Retirement Accounts (IRAs) and 401(k)s are intended to help regular workers save for a secure retirement, not to provide tax shelters for the rich. But extremely wealthy people, such as investment fund managers, can accumulate tens of millions of dollars in their IRAs – avoiding the contribution limits that apply to middle-class workers – by under-valuing the contributions they make to their IRAs.[43] For example, Mitt Romney's IRA is reported to be worth $87 million.[44]

This loophole is of dubious legality to begin with. But Congress can guard against abuses by enacting rules to limit the use of IRAs as tax shelters. For example, Congress could require distributions from IRAs if their value rises above a certain amount, or require retroactive taxation of contributions to IRAs if the value of those contributions rises above some set percentage.

- **Ensure Millionaires Pay at Least a 30 Percent Tax Rate ("Buffett rule")**
  Revenue: $54 billion over 10 years; Joint Committee on Taxation

  Closing the various loopholes that enable the very wealthy to shield income from taxation is good tax policy. But until that job is done, the "Buffett rule" (named after Warren Buffett, the billionaire who famously said he shouldn't pay a lower effective income tax rate than his secretary) will at least ensure that millionaires pay a tax rate equal to that of many middle-class families.

  Senator Sheldon Whitehouse has introduced legislation, S. 278, that would require taxpayers earning over $2 million to pay at least a 30 percent effective federal income tax rate. The minimum tax would begin to phase in at $1 million. This measure is estimated to raise $53.6 billion over 10 years).[45]

- **Close the "Like-Kind" Exchange Loophole**
  Revenue: $28 billion over 10 years; Citizens for Tax Justice

  Real-estate investors and multinational corporations have exploited a tax break ("like-kind exchanges") originally intended to enable farmers to exchange acreage, transforming it into a multi-billion dollar loophole that enables them to sell property at an appreciated price without paying capital gains taxes. This loophole has been widely exploited by many giant companies, including General Electric, Cendant and Wells Fargo.[46]

  The revenue loss due to the "like-kind exchange" tax break is $94 billion over 10 years, according to the JCT.[47] Congress could eliminate like-kind exchanges entirely or restrict who can take advantage of them. Citizens for Tax Justice estimates that reforms could net about $28 billion over 10 years.[48]

- **Close the "Carried Interest" Loophole for Multi-Millionaire Investment Fund Managers**
  Revenue: $17-21 billion over 10 years; Joint Committee on Taxation and Congressional Budget Office

  Very wealthy private investment fund managers can pay a lower tax rate on their earnings than many working Americans by arranging to receive their compensation as a share of profits ("carried interests"), so it is taxed at preferential capital gains rates. This income represents compensation for managing other people's investments, and should be taxed in the same manner as wages and salaries from all other jobs – as ordinary income. Closing this loophole would save between $17 billion and $21 billion over 10 years respectively, according to the JCT and CBO.[49]

Public opinion on this tax reform option

By a margin of 75% to 20%, voters want to "Eliminate the loophole that allows hedge fund managers to pay a lower tax rate than middle-class taxpayers."
Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

- **Eliminate the Medicare Tax Loophole for S Corporations**
  Revenue: $11 billion over 10 years; Joint Committee on Taxation

Certain highly paid professionals sometimes take advantage of a tax loophole made infamous by former Speaker of the House Newt Gingrich (R-GA) and former Sen. John Edwards (D-NC). These professionals – lawyers, accountants, doctors, consultants, and entertainment professionals – form "S corporations," whose profits are not subject to Medicare taxes and who characterize much of their income as profits of the business instead of salaries. Regular wage-earners can't do this, and neither can the owners of other kinds of small businesses. Government watchdogs have flagged the S corporation loophole as an area of rampant abuse. Legislation introduced in the House and in the Senate in recent years would shut down this loophole, requiring these well-heeled professionals to pay their fair share into Medicare. Closing this loophole has been estimated to raise $11 billion over 10 years, according to the JCT.[50]

- **Deny Mortgage Interest Deduction for Vacation Homes and Yachts**
  Revenue: $15 billion over 10 years; Committee for a Responsible Federal Budget

The mortgage interest deduction is intended to promote homeownership, but the tax code allows people to claim it not only on one property but on two. Moreover, under current Internal Revenue Service rules, a second home doesn't have to be a house – it can be a large boat, too. Under the rules, boats can qualify as second homes eligible for the tax break as long as they contain sleeping spaces, bathrooms (heads), and kitchens (galleys). In other words, only large boats qualify.

This is a perfect illustration of how a tax break intended to help middle-class people afford homes winds up subsidizing lavish lifestyles and costing more than it should. It makes little sense to maintain tax breaks on vacation properties or yachts while regular homeowners who can't afford such luxuries can claim only a deduction on one home and renters receive no deduction at all, especially at a time when budget constraints have put federal housing programs at risk. Limiting the mortgage interest deduction to primary residences could raise $15 billion over 10 years.[51] The deficit-reduction proposal made by Erskine Bowles and Alan Simpson, under the auspices of the National Commission on Fiscal Responsibility and Reform, also denied the mortgage interest deduction for second homes.[52]

- **Close the Tax Loophole for Derivatives Traders**
  Revenue: $3 billion over 10 years; Joint Committee on Taxation

  Warren Buffett calls this one of the "extraordinary tax breaks" for the "mega-rich." Due to a special rule in the tax code, certain derivatives traders pay a "blended" rate on their income—60 percent at favorable long-term capital gains rates and 40 percent at ordinary income rates.

  Although investors must generally hold onto assets for one year in order to enjoy low-rate capital-gain treatment, traders who buy and sell derivatives are eligible for the blended rate even if they buy and sell instantly. The loophole was carved out a generation ago to protect investors in commodities futures whose purpose was to protect long-term profits, not engage in short-term speculation. But financial markets have changed, and as Buffett explains, a trader can "own stock index futures for 10 minutes" and get the favorable tax treatment "as if they'd been long-term investors."[53]

  Sen. Carl Levin (D-MI) introduced legislation in the last Congress to close this loophole. The JCT estimated that the Administration's proposal to close the loophole would raise nearly $2.7 billion over 10 years.[54]

VI. Place a Surtax on the Incomes of Millionaires

Revenues: $107-$453 billion over 10 years; Joint Committee on Taxation

The fiscal-cliff tax deal restored tax rates on income above $450,000 for households ($400,000 for individuals) to their Clinton-era levels of 39.6 percent. This rate is still low by historical standards; from 1932 to 1986, the top marginal tax rate was at or above 50 percent.[55] And it leaves CEOs and investment managers making tens of millions of dollars paying the same marginal tax rate as a professional couple.

The richest 1 percent hold 35 percent of the nation's wealth and the bottom 90 percent owns just 23 percent.[56] The top 1 percent have seen their average after-tax income rise nearly four-fold since 1979, while the income of the middle 60 percent rose just 40 percent.[57] Despite these staggering differences, the U.S. tax code only has six income tax rates, with the top marginal rate of 39.6 percent applied equally to a professional couple making $450,000 a year and a CEO making $20 million. That is not right, nor does it make good economic sense.

It is time for the rich and the super-rich to contribute their fair share by paying higher marginal tax rates. A relatively simple way to do this is to place a surtax on income over $1 million a year, such as the 5.6 percent surtax that was proposed in the American Jobs Act debated in the Senate in 2011. This measure was estimated to raise $453 billion over 10 years by the JCT,[58] and it would affect just 2 out of 1,000 households (two-tenths of 1 percent of all taxpayers).[59] A more modest alternative would be to assess a 5 percent surtax on incomes of $10 million or more. This measure is estimated to raise $107 billion over 10 years, according to JCT.[60]

Public opinion on this tax reform option

- By a margin of 73% to 22%, voters support "Plac[ing] a surtax of five percent on a person's income over ten million dollars per year."
- By a margin of 67% to 28%, voters support "Plac[ing] a surtax of five percent on a person's income over one million dollars per year."
  Hart Research Associates Poll, Jan. 18-22, 2013, Q. 12

Endnotes

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[4] Corporate taxes have declined from 30.5 percent of federal revenue in 1953 to 7.9 percent in 2011. Office of Management and Budget, Fiscal Year 2013 Budget, Historical Tables (Table 2.2), http://www.whitehouse.gov/omb/budget/Historicals.

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[7] Kimberly A. Clausing, "A Challenging Time for International Tax Policy," *Tax Notes* (July 16, 2012), http://www.taxanalysts.com/www/website.nsf/Web/HomePage/$file/clausing.pdf.

[8] Citizens for Tax Justice (CTJ), "Working Paper on Tax Reform Options" (Feb. 4, 2013), p. 7, http://ctj.org/pdf/workingpapertaxreform.pdf The CTJ working paper estimate for fiscal years 2014-2023 is based on Joint Committee on Taxation (JCT) , "Estimated Revenue Effects of S. 3018, the 'Bipartisan Tax Fairness and Simplification Act of 2010'" (Nov. 2, 2010), p. 3 item 10, http://www.wyden.senate.gov/download/joint-committee-on-taxation-estimated-score-of-the-bipartisan-tax-fairness-and-simplification-act-of-2010. The JCT revenue estimate also includes the Wyden-Coats (formerly Wyden-Gregg) proposal to impose a country-by-country limit on foreign tax credits.

[9] *Ibid*., pp. 10-13. These revenue figures are CTJ's estimates for fiscal years 2014-2023 based on the JCT's scores of the various proposals by President Obama for earlier 10-year budget periods.

[10] *Ibid.,* p. 10. The Treasury Department estimated a much higher revenue yield from reforming "check the box." CTJ projects that the proposal would raise $115 billion over fiscal years 2014-2023 based on prior Treasury estimates.

[11] The White House and the Department of the Treasury, "The President's Framework for Business Tax Reform," (Feb. 2012), http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf.

[12] CTJ, "Policy Options to Raise Revenue" (March 8, 2012), p. 12, http://ctj.org/pdf/revenueraisers2012.pdf.

[13] JCT, Estimated Budget Effects of the Revenue Proposals Contained in the President's Fiscal Year 2013 Budget Proposal (JCX-27-12) (March 21, 2012), Section XIV, H and I, p. 11, https://www.jct.gov/publications.html?func=startdown&id=4413

[14] Contract price of crude oil was $97.01 for March 13, 2013, *see* http://www.bloomberg.com/energy/ (Feb. 12, 2013).

[15] JCT, (JCX-27-12) Section XIII, pp. 10-11, *supra* note 13. This estimate does not include the Obama Administration's proposal to reform the rules regarding "dual capacity" taxpayers. Though oil companies are a

principal beneficiary of the existing “dual capacity” rules, that reform proposal is included in the previous section on international tax loopholes.

[16] See CTJ, “Policy Options to Raise Revenue,” pp. 15-16, *supra* note *12.*

[17] Unpublished JCT source confirmed by Sen. Levin’s tax counsel (Feb. 6, 2013); S. 1375 and S. 2075, 112th Congress, http://www.levin.senate.gov/newsroom/press/release/levin-brown-bill-would-end-corporate-stock-option-tax-break-reduce-deficit-by-25-billion.

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[20] Letter from Sen. Tom Harkin to Co-Chairs of the Joint Select Committee on Deficit Reduction (Nov. 8, 2011), http://www.harkin.senate.gov/documents/pdf/4eb9a83a52ae2.pdf.

[21] CTJ, “Working Paper on Tax Reform Options” (Feb. 4, 2013), pp. 13-14, http://ctj.org/pdf/workingpapertaxreform.pdf. This estimate for 2014-2023 is based on previous Joint Committee on Taxation estimates of the proposal, and takes into account changes made by the American Tax Reform Act. The Treasury Department’s past estimates for the proposal were higher than JCT’s, which CTJ estimates would raise $583 billion over the same period.

[22] Lawrence Summers, “How to target untaxed wealth,” Reuters blog (Dec. 17, 2012), http://blogs.reuters.com/lawrencesummers/2012/12/17/how-to-target-untaxed-wealth/

[23] Chye-Ching Huang & Chuck Marr, CBPP, “Raising Today’s Low Capital Gains Tax Rates Could Promote Economic Efficiency and Fairness, While Helping to Reduce Deficits” (Sept. 19, 2012), p. 25, http://www.cbpp.org/files/9-19-12tax.pdf.

[24] JCT, “Estimates of Federal Tax Expenditures for Fiscal Years 2012-2017,” (Feb. 1, 2013), JCS-1-13, p. 34, https://www.jct.gov/publications.html?func=startdown&id=4503. JCT estimated the revenue gain at $258 billion from 2013-2017, which over 10 years would be at least $516 billion.

[25] An existing provision already excludes an amount of gain on homes from capital gains tax.

[26] This policy proposal was not mentioned in the “Moment of Truth” report, but was contained in the revenue analysis done for the commission by the Tax Policy Center (TPC), T10-0247, Bowles-Simpson Deficit Commission (Nov. 16, 2010), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2846&DocTypeID=2.

[27] NWLC calculations based on Tax Policy Center Table T09-0492, Distribution of Long-Term Capital Gains and Qualified Dividends by Cash Income Percentile, 2012 *available at* http://www.taxpolicycenter.org/numbers/Content/PDF/T09-0492.pdf.

[28] *Ibid.*

[29] Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085 (1986).

[30] Donald Marron, TPC, “Health Reform’s Tax on Investment Income: Facts and Myths,” *Tax Notes* (January 30, 2012), http://www.taxpolicycenter.org/UploadedPDF/1001585-TN-health-reform-investment-facts-myths.pdf.

[31] In 2012, Citizens for Tax Justice estimated that taxing capital gains as ordinary income would raise $533 billion over a decade, assuming the Bush-era reductions in rates for capital gains and stock dividends had already expired. Today, the rate reductions have expired for capital gains in the top income tax brackets (where most capital gains are taxed) but the rate reduction for stock dividends was partially extended. That means this proposal would likely raise more than was previously estimated because it would also end the remaining break for stock dividends (raising the top rate for stock dividends from 20 percent to 39.6 percent.) See CTJ, “Policy Options to Raise Revenue” (March 8, 2012), pp. 5-7, http://ctj.org/pdf/revenueraisers2012.pdf.

[32] NWLC calculations from TPC, “Estate Tax Returns and Liability Under Current Law and Various Reform Proposals, 2011-2021” (Table T13-0019) (Jan. 9, 2013), http://www.taxpolicycenter.org/numbers/Content/PDF/T13-0019.pdf

[33] Compare JCT, “Estimated Revenue Effects of an Amendment to the Senate Amendment to H.J. Res. 66” (JCX-78-12) (Dec. 19, 2012) p. 3, https://www.jct.gov/publications.html?func=startdown&id=4496, with JCT, “Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 8, the

‘American Taxpayer Relief Act of 2012,’ as passed by the Senate on January 1, 2013” (JCX-1-13) (Jan. 1, 2013), https://www.jct.gov/publications.html?func=startdown&id=4497.

[34] NWLC calculations from TPC Table T13-0019, *supra* note 32.

[35] NWLC calculations comparing JCT, “Modeling the Federal Revenue Effects of Changes in Estate and Gift Taxation” (JCX-76-12) (November 9, 2012), p. 12 (adding estimates for FY 2013-2022), https://www.jct.gov/publications.html?func=startdown&id=4492, with JCX-1-13, *supra* note 33.

[36] With an exemption of $2 million per couple, $1 million per individual, 1.7 percent of estates would owe estate tax in 2013. NWLC calculations from TPC Table T13-0019, *supra* note 32. With an exemption of $2.6 million per couple, even fewer estates would be taxed.

[37] NWLC calculations from revenue estimates for H.R. 3467 by JCT in Letter from Thomas Barthold, Chief of Staff, JCT, to Representative James McDermott (March 27, 2012) (on file with NWLC).

[38] For further explanation see Seth Hanlon & Sarah Ayres, “Loopholes in the Estate Tax Show Why Revenue Must Be on the Table,” Center for American Progress (Jan. 24, 2013), http://www.americanprogress.org/issues/tax-reform/news/2013/01/24/50457/loopholes-in-the-estate-tax-show-why-revenue-must-be-on-the-table/.

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[43] See Mark Maremont, “Bain Gave Staff Way to Swell IRAs by Investing in Deals,” *Wall Street Journal* (March 29, 2012), http://professional.wsj.com/article/SB10001424052970204062704577223682180407266.html?mg=reno64-wsj.

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